



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	01/07/02	Bill No:	ACA 13
Tax:	Business, Property, Income	Author:	Leonard
Board Position:	Neutral	Related Bills:	

BILL SUMMARY

This proposed constitutional amendment would rename the Board of Equalization (BOE) as the California Tax Commission and would require the Commission to collect and administer income and withholding taxes and conduct administrative review of state tax matter determinations.

ANALYSIS

Current Law

Under existing law, the BOE administers, among other things, the state and local sales and use tax, local transactions and use taxes, the gasoline, jet fuel and use fuel taxes, the insurance gross premiums tax, the cigarette and tobacco products taxes, the alcoholic beverage taxes, the hazardous waste taxes and fees, the energy resources and emergency telephone users surcharges, the timber tax and the private railroad car tax. The BOE also assesses the property of public utilities and common carriers, and provides certain administrative and oversight functions with respect to the local property tax.

The BOE comprises four elected members, one from each equalization district, and the State Controller. The board itself is responsible for setting the values for the board roll (utilities and common carriers). It also hears appeals relating to all of the taxes it administers, as well as the taxes administered by the FTB.

The Franchise Tax Board (FTB) was created by law and comprises the Controller, the Director of Finance, and the Chairman of the BOE. It administers the personal income tax and the bank and corporation tax. In addition, the FTB administers other non-income tax related programs, including the Homeowners' and Renters' Assistance program, child support and other non-tax debt collection programs, Political Reform Audit, and the Non-admitted Insurance Tax program. Administrative responsibility for income tax withholding is delegated to the Employment Development Department (EDD).

The FTB and the BOE adopt rules and regulations for the taxes which the respective departments administer.

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Proposed Law

This bill would amend the various sections of the California Constitution to rename the State Board of Equalization as the California Tax Commission.

This bill would also add 17.5 to Article XIII to the California Constitution to require the California Tax Commission, in addition to its other powers and duties, to collect and administer taxes on or measure by income that are imposed on persons, corporations, or other entities as prescribed by law, and any taxes that are withheld from wages. The Commission would also conduct administrative review of state tax matter determinations.

In General

The BOE, FTB, and the Tax Branch of the EDD, in December 1993, formed a Strategic Tax Partnership (STP) to do the following: (1) address any significant differences in policies, procedures, or standards among the state's three taxing agencies; (2) improve service to California's taxpayers; and (3) increase compliance with the state's tax laws. The STP is modeled on the concept of a virtual organization - a network of independent organizations linked to share skills, costs, knowledge, and resources while maintaining their independent organizational forms.

In 1994, the Legislature and the Governor provided additional direction to the STP in the 1994 Budget Act that required the partner agencies to develop a plan for integrating tax information systems and explore joint business ventures to improve sharing of information, increase tax compliance, reduce the reporting burden on taxpayers, and provide greater taxpayer convenience.

The first task of the STP, with participation from the Department of Finance and the Legislative Analyst's Office, was the development of a strategic plan. The plan would identify the STP's vision, shared values, initial joint projects, and serve as their road map. Over the years, the STP has accomplished the goals as identified in the plan. The next step for the STP is to merge with the Internal Revenue Service, creating a formal "FedState" Program. This FedState collaboration is expected to build better connections among information systems, improve information sharing, provide greater service to taxpayers, and enhance the efficient administration of the state's tax programs.

Background

Several bills have been introduced over the years that have proposed to consolidate the FTB *into* the BOE. These include:

- AB 15 (Klehs, et al.), as amended August 8, 1994, which was vetoed by Governor Wilson. In part, the veto message states, "...I support streamlining government and consolidating the Board of Equalization and the Franchise Tax Board. AB 15 is not the way to accomplish this purpose. The Administration sponsored legislation that would have created a Department of Revenue within the Administration. That

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approach would avoid the conflict of interest inherent in AB 15, in which the Board of Equalization serves as both administrator of the tax system, as well as the appellate body for taxpayer appeals.”

- AB 3338 (McClintock), as introduced February 20, 1992, which failed passage in the Assembly Revenue and Taxation Committee.
- SB 1052 (Alquist), introduced March 7, 1989, which was never heard in committee.

Other measures have also been presented before the Legislature which would consolidate the FTB and the BOE. These include:

- AB 2794 (Bowen, et al) of the 1995-96 Session, which failed passage in the Assembly Revenue and Taxation Committee.
- SB 1727/SCA 29 (Kopp), also of the 1995-96 Session, which was held in the Senate Appropriations Committee.
- SB 2137 (Campbell), as amended August 8, 1994, which failed passage in the Senate Appropriations Committee.
- SB 1829 (Campbell), as amended April 25, 1994, which was never heard in committee.
- SB 87 (Kopp), as amended January 27, 1994, which failed on the Senate floor.
- SB 23 (Kopp), as amended January 23, 1992, which failed to move out of the Senate.
- SB 1395 (Kopp, Ayala, et al.), as amended May 25, 1989, which failed passage in the Senate Appropriations Committee.
- SB 1695 (Kopp), as amended on February 20, 1992, which was sent to interim study. The Assembly Revenue and Taxation Committee held an oversight hearing on February 24, 1992, which reviewed specific issues related to consolidating the FTB and the BOE into a Department of Revenue. The issues discussed included: administration, audit, collections, return processing, legal divisions/appeals process, facilities, and data processing. It was noted in the hearing that the state's budget crisis made consolidation less attractive at the time due to its costs and complexities.

COMMENTS

The following comments relate to the creation of a consolidated California Tax Commission. Some comments address arguments made in support or opposition to previously introduced legislation to consolidate the agencies.

1. **Sponsor and purpose.** This measure is sponsored by the author and is intended to streamline administration of the income tax system.

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2. **January 7, 2002 amendments change the name of the proposed commission from the Tax Appeals Commission to the California Tax Commission.**
3. **Consolidating the more significant taxes would provide public convenience.** It would provide convenience for the public (single stop service and more locations where the taxpayer could go for a variety of services). However, housing both the current FTB and BOE headquarters in one building would necessitate a major, costly reorganization.
4. **Consolidating would provide uniform tax policy and administration.** It would provide more uniform tax policy and administration. It would assure citizens greater uniformity in the compliance and appeals processes and provide an opportunity to simplify and reduce regulations, and to reduce and standardize the number of taxpayer reports that need to be filed.

While the argument of uniformity has some merit, there is little similarity between the income taxes administered by FTB and the business taxes administered by the BOE. The tax bases and the due dates are not similar, and, although the majority of taxpayers registered with the BOE also pay income tax, the reverse is not true. Also, one could not reduce the number of regulations or taxpayer reports, since the regulations and reports related to different taxes involve totally different subject matter and required information.

Also, an argument has been made that it is difficult to achieve consistent policy and administrative uniformity when various taxes are under the jurisdiction of different agencies. Further, it has been said that the existence of a consolidated tax agency would make it easier to develop a state tax policy in relation to revenue sources and needs.

Tax policy, as it relates to raising revenue to meet budgeted needs, is developed by the Legislature and not by the agencies themselves. However, one would expect consistency and uniformity in administration to improve taxpayer compliance.

5. **Consolidating would reduce administrative costs.** It would reduce administrative costs, since it would result in the consolidation of administrative and staff services, including personnel and training. Also, it would avoid duplication of collection efforts, fiscal duties, and mailing costs. Some argue that the audit and legal staffs could be consolidated and reduced (this argument assumes that the auditors and attorneys would be knowledgeable about all the various taxes and that they could be given assignments in any area of taxation, depending on workload fluctuations). Also, a suggestion has been made that one tax booklet could cover all taxes.

While it is true that administrative costs could be reduced in the long run, initially a consolidation would actually create additional work for the administrative staff, since it would take a significant amount of time to develop the consolidated systems and

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processes. Until the new systems are operational, it would be necessary to run parallel processes using the old systems.

It is questionable that the audit and legal staffs could be reduced substantially through consolidation. As noted previously, the taxes are significantly different, and transfer of auditors and attorneys between the tax programs would not be effective. In fact, the differentiation among the various taxes is the reason that the BOE's auditors and attorneys currently specialize in one area of taxation. Workload would not decrease as a result of this bill and additional time and expense would be necessary to cross-train staff. Current production levels would decline until such time as proficiency was attained, if such proficiency could, in fact, be attained given the differences in tax programs.

In reference to the final suggestion, it would not be efficient to publish a tax booklet covering all taxes. Currently, there are separate tax guides for sales and use taxes, each excise tax, personal income tax and bank and corporation tax. A booklet covering all these taxes would basically encompass the entire Revenue and Taxation Code. Since the taxes are entirely different, are based on different information in the taxpayers' records, and the groups of taxpayers are not identical, it is more economical to publish separate booklets and send them to the taxpayers who actually need information about each specific tax.

6. **Audits could be consolidated.** Some proponents argue that if the tax administration were consolidated into one agency, all taxes could be audited at the same time. However, there are several reasons why this is doubtful; some of the most significant are:

- The inherent differences in the nature of the sales tax and the income tax limit the similarities in the two agencies' taxpayer account universe. For example, a study of 496 accounts sampled indicated that only 4 accounts were audited by both the FTB and the BOE.
- Both agencies currently select accounts for audit based on the likelihood of a productive audit. Each agency, however, uses a selection method unique to each tax program.
- Sales tax audits routinely cover a three-year period, while personal income tax audits are generally done on a line-item/single-year basis, and bank and corporation tax audits generally cover a two-year period.
- The feasibility, effectiveness, and efficiency of a "one audit for all taxes" concept has not yet been demonstrated. One auditor auditing more than one tax program would be required to maintain a high level of knowledge in those programs. It is questionable whether one auditor could maintain sufficient expertise in all tax areas to be effective; therefore, both agencies currently limit the number of tax programs in which their auditors must be proficient. Auditors would be required to

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stay current with respect to all taxes, and the time and effort spent on this monumental task would reduce the time available for auditing. Since the auditors would not possess the same skills and knowledge that the current specialist auditors do, they would be more likely to miss some unreported tax. This would be particularly true when taxpayers were using ingenious techniques to hide tax liability. A "team" concept would overcome this problem, but has its own drawbacks.

7. **Data processing operations could be consolidated.** Proponents state that consolidation of the data processing operations of both agencies could provide for improved information management and produce economies of scale.

The BOE maintains its computer application systems within the Teale Data Center's (TDC) IBM environment. Such a complex consolidation of data processing functions among the tax agencies would require a strategic plan that would address a myriad of issues (e.g., whether to develop a consolidated database(s), whether to combine the physical data networks of the two agencies, etc.).

Any economies of scale to be realized would depend on the vision and technological strategies of the new organization. All indications are that short-term costs would increase to plan and implement the consolidation. Long-term (e.g., 10 years) savings, after the BOE and the FTB programs were operationally combined, appear to be more likely, as a single network could support the operations. A consolidation plan, however, would require that the two existing data processing operations continue to function for at least some time.

8. **Since consolidation of tax agencies is the nationwide trend, California should consolidate.** It is argued that consolidation of the tax agencies would be consistent with the national trend to organize the administration of major taxes in one agency. In addition, several studies have recommended consolidation of the BOE and the FTB.

While it is true that many states have consolidated their taxing agencies, this does not ensure that consolidation would result in increased efficiency and effectiveness in California. California's economy is significantly larger than that of any other state. In fact, California is now the fifth largest economy in the world. What works in other smaller settings would not necessarily work as well in California. Moreover, California has long been regarded as having one of the best, if not the best, tax administration operation in the nation, and other states look to California for leadership. It is doubtful that a major reorganization would improve this exemplary record. In addition, the FTB and BOE individually are larger than almost all other state revenue departments. The enormity of a consolidated department might itself increase complexities of the administrative structure by adding more decision making levels. Consolidation of the FTB and BOE would result in a tax administration organization second only in size to the Internal Revenue Service. Responsiveness could actually decrease simply because of the size of the bureaucracy.

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As noted previously, in 1993, the BOE, FTB and the Tax Branch of the EDD formed a Strategic Tax Partnership in order to provide a new level of functional integration and cooperative business processing among the three agencies. These agencies have numerous projects underway which would improve service to California's taxpayers and to increase compliance with California's tax laws.

The BOE has also begun a major restructuring effort to improve operational efficiency. Some of the more significant efforts include: consolidation of some of the Board's smaller central and northern California district offices, implementation of an automated collection management system to improve the Board's tax collection functions, and the transfer of all the Board's mainframe computer applications from the Board's in-house mainframe to the Teale Data Center.

Governor Reagan's Reorganization Message in 1969 recommended consolidation of California's taxing agencies. In the same message, Governor Reagan also recommended "a more consolidated, integrated organization to deal with the public aspects of health." Although the taxing agencies were not consolidated at that time, an attempt was made to consolidate the Department of Health. The reorganization began in early 1973 and the Department of Health became a fully budgeted working organization during that year.

Staff members who were involved in that consolidation note that the attempted conversion was extremely difficult. In fact, some argue that the agency never came together as a cohesive unit. Any economies of scale were offset by the fact that management was unable to address the needs of individual programs. Also, it was difficult for the highest level of management to have a clear understanding of all the various programs. Because of these difficulties, the single agency was again split into separate agencies a few years later. This experience, at a minimum, leads one to question whether consolidation is a clear answer in all situations.

9. **There is no overwhelming reason to consolidate.** In an overall view of the arguments in favor of and against the consolidation of the taxing agencies, it appears there is no *overwhelming* reason to do so. The FTB, the BOE, and the EDD are operating efficiently, and in today's environment, modern technology actually makes physical consolidation less critical. California has an outstanding record in the field of tax collection and administration. Since it is unclear whether the consolidation would result in significant improvements, it appears that it may not be warranted to incur the costs of consolidation or to risk any loss of revenue during the period of conversion.
10. **Whether economies of scale would be realized is questionable.** Opponents of similar proposals in the past have noted that the contentions of greater economy are largely illusory. Unless certain programs were curtailed, there would still be essentially the same staff requirements and space requirements.

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This argument was also made with respect to the attempted consolidation of the Department of Health. It was noted that it was necessary to maintain the existing separate administrative processes until the conversion was entirely complete in order to assure that no task was overlooked. In other words, in a consolidation of agencies, during the conversion period, the administrative duties would actually increase. The actual experience of the Department of Health reorganization proves this argument to be valid.

Also, it is clear that a major reorganization would require significant staff time, simply to determine the appropriate direction of the new agency in terms of each duty assigned to it. The result is that much of the continuing, every day work would be slowed down. There is a significant concern that this result would be particularly detrimental in a tax agency during a period when every effort is being made to maintain or increase state and local revenues. Further, if there are not significant improvements in efficiency and effectiveness of tax collection in the long run, it could take several years to recover from any losses in revenue during the conversion period.

11. **Consolidation efforts could pose a risk to revenue flow.** While there is no definitive argument to support consolidation, there are risks created by the disruption of a consolidation, as evidenced by the Department of Health consolidation. The FTB and BOE are operating efficiently, and California has an outstanding record in the field of tax collection. Since it is unclear whether the consolidation would result in significant improvements, it may not be warranted to incur the costs of consolidation or to risk any loss of revenue during the period of conversion.

TECHNICAL ISSUES

12. **All sections in the Revenue and Taxation Code referring to the BOE and FTB should be amended.** For example, the Revenue and Taxation Code requires the FTB to collect and administer the income tax. This proposed constitutional amendment would be in conflict with the Revenue and Taxation Code, since the proposed California Tax Commission would be charged with that responsibility. Accordingly, in order to effectively accomplish the transfer of duties and responsibilities from the FTB to the BOE, it is recommended that each section in current law which refers to these agencies be amended.
13. **Operative date of bill may not allow time to establish California Tax Commission.** The proposed constitutional amendment, if approved by the voters, would become operative the day following passage by the voters. Depending on the date voters approve the ACA, there would not be sufficient time to transfer the income tax collection and administration responsibilities to the California Tax Commission.

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COST ESTIMATE

This proposed constitutional amendment in and of itself would not affect administrative costs. Numerous studies have been prepared since the 1940's examining the advantages and disadvantages of consolidation. Some of these studies have cited projections of costs and savings associated with various aspects and forms of consolidation; however, none of these studies have provided any detail to support these amounts. Since there are many variables which would affect the cost associated with consolidation of the tax agencies, it is not possible to prepare a reliable estimate. In general, there could be increases in various costs, including, but not limited to, training (if auditors were required to learn about other tax programs), administrative costs (to maintain parallel administrative processes during conversion), space, and equipment. It is also possible that there could be savings related to combined efforts in various areas, including collection, fiscal functions, and mail processing, but the amount of these savings could not be determined without an extensive, detailed study.

REVENUE ESTIMATE

This proposed constitutional amendment in and of itself would not affect the state's revenues. In general, the transfer of the tax collection and administration responsibilities of the income taxes to the BOE would not appear to have any effect on the state's revenues. It is possible, however, that a decrease in revenue could be experienced during the period of conversion as a result of the requirement to spend staff time developing the procedures for the new agency. Also, if the effort was similar to that of the Department of Health in the 1970's, there may be some transitional problems which might also have a negative impact on revenue.

Analysis prepared by:	Sheila T. Sarem	445-6579	01/16/02
Contact:	Margaret S. Shedd	322-2376	
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